Supreme Court, U.S.
FILED
JUN 26 1995
OFFICE OF THE CLERK

No. 94-1823

In the Supreme Court of the United States

OCTOBER TERM, 1994

NATIONAL COMMODITY AND BARTER ASSOCIATION, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

JONATHAN S. COHEN
ROBERT W. METZLER
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

BEST AVAILABLE COPY

18 pp

QUESTION PRESENTED

Whether petitioner was correctly found liable for penalties under 26 U.S.C. 6698 for its failure to file income tax returns required by 26 U.S.C. 6031.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	9
Conclusion	14

TABLE OF AUTHORITIES

Cases:

Commissioner v. *Culbertson*, 337 U.S. 733 (1949)	12
First Nat'l Bank, In re, 701 F.2d 115 (10th Cir. 1983)	2
Grand Jury Proceeding, In re, 842 F.2d 1229 (11th Cir. 1988)	4
Lewis v. *Reynolds*, 284 U.S. 281 (1932)	12
NAACP v. *Alabama*, 357 U.S. 449 (1958)	13
NAACP v. *Claiborne Hardware Co.*, 458 U.S. 886 (1982)	13
Pleasant v. *Lovell*, 974 F.2d 1222 (10th Cir. 1992)	13
Tiffany Fine Arts, Inc. v. *United States*, 469 U.S. 310 (1985)	12
United States v. *Becker*, 965 F.2d 383 (7th Cir. 1992), cert. denied, 113 S. Ct. 1411 (1993)	4
United States v. *Boyle*, 469 U.S. 241 (1985)	10
United States v. *Dack*, 987 F.2d 1282 (7th Cir. 1993)	4
United States v. *Felt & Tarrant Mfg. Co.*, 283 U.S. 269 (1931)	10
United States v. *Hawley*, 855 F.2d 595 (8th Cir. 1988), cert. denied, 489 U.S. 1020 (1989)	4
United States v. *Janis*, 428 U.S. 433 (1976)	12
United States v. *Stelten*, 867 F.2d 446 (8th Cir.), cert. denied, 493 U.S. 828 (1989)	4

Constitution, statutes and regulation:

	Page
U.S. Const. Amend. I	13
Internal Revenue Code (26 U.S.C.):	
§ 527(e)	11
§ 527(e)(1)	11
§ 527(e)(2)	11
§ 761(a)	7, 8, 9, 13
§ 6031	9
§ 6031(a)	9
§ 6698	6, 7, 8, 9, 10, 12
§ 6698(a)	6, 9
§ 6698(b)	6, 9
§ 6700	6, 7
26 C.F.R. 301.6651(c)(1) (1984)	10

In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1825

NATIONAL COMMODITY AND BARTER ASSOCIATION, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B1-B6) is unofficially reported at 74 A.F.T.R. 2d (RIA) 94-7385 and is noted at 42 F.3d 1406 (Table). The opinion of the district court (Pet. App. A1-A23) is reported at 843 F. Supp. 655.

JURISDICTION

The judgment of the court of appeals was entered on November 29, 1994. The petition for rehearing was denied on February 6, 1995. Pet. App. C1. The petition for a writ of certiorari was filed on May 5, 1995. The

jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. Petitioner[1] describes itself as a "voluntary, non-commercial, political and educational association" (Pet. App. A1-A2, B2). Founded in 1979, petitioner had approximately 2,000 members in the early 1980s (*id.* at B2). Petitioner operated a "warehouse bank," known as the National Commodity Exchange (NCE), which conducted a substantial volume of business (*id.* at A2, A17). According to the former manager of the bank's day-to-day operations, the bank had gross receipts of approximately $25,000,000 in 1984 (C.A. Supp. App. 349-350). Records obtained from two of the commercial banks at which petitioner maintained accounts established that petitioner made deposits at those banks in excess of $17,000,000 in 1983 and in excess of $15,000,000 in 1984 (*id.* at 346). Petitioner refused to provide information about the accounts it maintained at other banks. See, *e.g.*, *In re First Nat'l Bank*, 701 F.2d 115 (10th Cir. 1983).

Petitioner's "warehouse banking" system was designed to thwart enforcement of the federal tax laws

---

[1] In the pleadings, the National Commodity and Barter Association/National Commodity Exchange represented itself as a single plaintiff, stating that "Plaintiff, National Commodity and Barter Association/National Commodity Exchange ('NCBA/NCE') is a voluntary, non-commercial, political and educational association" (C.A. App. 1). In its notice of appeal, the National Commodity and Barter Association/National Commodity Exchange again described itself as a single entity (*id.* at 141). Although the National Commodity and Barter Association/National Commodity Exchange now states in the petition that it is two distinct parties, we nevertheless refer to that entity as "petitioner."

by providing a means for taxpayers to conceal their income and assets (Pet. App. A4, A20). According to literature distributed by petitioner, it was "impossible, with the NCE system, for the IRS to violate your privacy and establish either civil or criminal liability against you" (C.A. Supp. App. 337, 343). Under the NCE system, a member would open an account that identified him only by an account number and not by name. The member would then deposit funds into the NCE account and receive a "warehouse receipt" for the amount of gold or silver that was allegedly purchased with the deposit (*id.* at 266, 343). When a member deposited a check into his NCE account, petitioner would negotiate it along with several hundred other checks so that, as petitioner's literature explained, "no one is going to know who or what belongs to whom. Not without an *extensive* amount of research, at least" (*id.* at 345).

Petitioner did not keep records of its members' deposits. Instead, it kept only the last "warehouse receipt" for each account. That receipt showed the account balance and the account number but contained "no summation of [the member's] transaction activity" (C.A. Supp. App. 343). Petitioner's literature asserted that the account offered by petitioner was "similar to a Swiss bank account" but "much better" (*ibid.*).[2]

---

[2] Petitioner's warehouse banking account also provided "paper-trail" protection on the withdrawal side of the banking transaction. For example, if a member needed to pay another exchange member, he could accomplish it through an account-to-account transfer that left no record of the transaction at the exchange. If a third party was involved, the exchange member would send his bill or invoice from the third party to the exchange and the exchange would pay it using an exchange check that did not identify the member. The member would

Many of petitioner's members used its "warehouse banking" system in an effort to evade taxes. See, *e.g.*, *United States* v. *Dack*, 987 F.2d 1282, 1285 (7th Cir. 1993) (member "followed the tax protestor strategy of * * * utilizing a warehouse bank run by a protester organization in an attempt to hide his money and his monetary transactions from the IRS"); *United States* v. *Becker*, 965 F.2d 383 (7th Cir. 1992) (doctor used NCE account to evade more than $300,000 in federal income taxes on $850,000 of income earned from practice of medicine), cert. denied, 113 S. Ct. 1411 (1993); *United States* v. *Hawley*, 855 F.2d 595, 598 (8th Cir. 1988 ("circuitous check-cashing system allowed NCBA members to convert checks into cash without leaving any record at a commercial bank of a cash withdrawal attributable to them"), cert. denied, 489 U.S. 1020 (1989); *United States* v. *Stelten*, 867 F.2d 446, 451 (8th Cir.) ("customer's warehouse receipt file is proof of the way in which he or she used the NCE's financial services to conceal income"), cert. denied, 493 U.S. 828 (1989); *In re Grand Jury Proceeding*, 842 F.2d 1229, 1230 (11th Cir. 1988) ("The financial system operated by NCBA obviously provides significant opportunities for the evasion of federal tax laws, especially requirements for the reporting of taxable income.").

---

receive a copy of the check and a warehouse receipt showing a new (reduced) account balance. As in the case of a deposit, the only record kept by the exchange was a copy of the last warehouse receipt. The receipt provided the current account balance but did not contain information about the member's transaction (C.A. Supp. App. 117-118, 266-267, 273, 274, 277, 302, 326-327, 343).

b. There were two types of fees charged for NCE services (C.A. Supp. App. 283-285). First, an annual membership fee was charged that ranged from $100 to $180 (Pet. App. A3). Second, petitioner's members paid transaction charges for use of the bank. Deposit fees ranged from 1.25% of the deposit amount for large deposits to 4.5% of the deposit amount for small deposits (C.A. Supp. App. 283-284). Additional charges were assessed for other services, such as mailing cash by registered mail (*id.* at 54, 117-118).

Petitioner's newsletter was sent to all of its members. The newsletter represented that "[t]he Warehouse Exchange always belonged to the members" (C.A. Supp. App. 314) and that "[t]he NCE was a service wing of the NCBA * * * that * * * benefited all members jointly" (*id.* at 313). In petitioner's words, "[t]he entire association membership functions in the capacity of a bank board of directors" with respect to loans made to petitioner's members through the exchange mechanism (*id.* at 343) and "[w]hen an NCBA warehouse makes purchases [of gold and silver], they do so * * * on behalf of the association, not the member" (*id.* at 309).

Petitioner also published "Freedom Books" describing its official position. These books contained the following "*WARNING*" (C.A. Supp. App. 150; see Pet. App. A3):

> THE AUTHOR DOES NOT RECOMMEND FILING A TAX RETURN. PERSONS FILING ANY TAX RETURN AT ALL DO SO AT THEIR OWN RISK!

From 1979 through 1988, petitioner followed its own advice and did not file any federal tax return (Pet. App. A7; C.A. Supp. App. 8). Petitioner also did not provide its members, employees or contractors with forms

reporting their income (C.A. App. 261; C.A. Supp. App. 8, 53, 66, 69, 105). Nor did petitioner seek or obtain a ruling from the IRS that it was a non-profit or tax-exempt organization (Pet. App. A7).

c. On June 22, 1990, the Internal Revenue Service assessed penalties against petitioner in the total amount of $4,223,000 under Section 6698 of the Internal Revenue Code (Pet. App. A2). Section 6698 provides penalties for a taxpayer's failure to file partnership income tax returns. 26 U.S.C. 6698. The amount of the penalty "for any month is the product of * * * $50, multiplied by * * * the number of persons who were partners in the partnership during any part of the taxable year." 26 U.S.C. 6698(b). The penalty may be imposed for a maximum of five months for any taxable year. 26 U.S.C. 6698(a). In assessing the penalty, the Service determined that petitioner had 1,498 partners in each of the years 1979 through 1983, 1,962 partners in 1984, and 1,860 partners in each of the years 1985 through 1988 (C.A. App. 326). The Service computed the amount of the penalty assessment for each year by multiplying $250 ($50 per partner for a maximum of five months) times the number of partners.

The penalty assessments for 1979 through 1983 were satisfied by application of an overpayment resulting from a partial abatement of penalties previously assessed against petitioner under Section 6700 of the Code. Petitioner filed administrative claims for refund with respect to the Section 6698 penalties for the years 1979 through 1983 (Pet. App. B3). After the IRS denied those claims, petitioner filed suit in district court to obtain a refund of the penalties it had paid and an injunction to prevent the Service from collecting

the penalties that remained outstanding.[3] The pleadings alleged six "grounds for recovery" (C.A. App. 6) but did not contend that petitioner had reasonable cause for failing to file partnership returns (*ibid.*).

The district court concluded that petitioner failed to meet its burden of proving that the Service had erroneously assessed the Section 6698 penalty (Pet. App. A16). The court rejected petitioner's assertion that it was not a partnership. The definition of a partnership under Section 761(a) of the Internal Revenue Code includes any "syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on" (26 U.S.C. 761(a)). The court noted that this statutory definition is significantly broader in scope than the common law concept of a "partnership" (Pet. App. A10-A11) and that "[t]he breadth of the statutory term indicates it was designed as a catch-all so as to encompass consciously amorphous associations such as [petitioner]" (*id.* at A11-A12). The court concluded that petitioner carried on a significant amount of "financial operation[s]" and therefore fell within the broad reach of Section 761(a) (Pet. App. A17).

The court explained that "[t]he deliberate formlessness and secrecy of the NCE, made it reasonable for the IRS to assess this penalty" (Pet. App. A16). Because "[t]he NCE was the core of the financial operations, * * * the partnership could most plausibly be defined as all NCE account-holders" (*ibid.*). Since

---

[3] The suit that was initially filed sought a refund of penalties assessed under Section 6700 of the Code. Petitioner does not request review of the Tenth Circuit's holding in favor of the government on that issue (Pet. 5).

petitioner provided no way to determine who specifically held accounts at the NCE, the court concluded that, in computing the penalty under Section 6698, it was appropriate to regard all of petitioner's members as partners of the organization (Pet. App. A16).

The court rejected petitioner's assertion that "the penalties were a pretext to destroy individual members' First Amendment right of free association and speech" and that "a decade long IRS conspiracy against it has led to the deprivation of members' First Amendment rights" (Pet. App. A21). The court found that "the evidence at trial revealed no such conspiracy" (*ibid.*).

2. The court of appeals affirmed (Pet. App. B1-B6). Petitioner conceded on appeal that, because its organization fell within the broad definition of a partnership in Section 761(a), petitioner was required to file informational partnership returns (Pet. App. B4). Petitioner contended, however, that the district court overlooked that a penalty is not imposed under Section 6698 if the taxpayer had "reasonable cause" for failing to file a return; petitioner submitted that its failure to file should have been excused under this provision.

The court of appeals rejected petitioner's contention. The court noted that "the 'reasonable cause' issue" had not been "adequately raised, preserved or presented by [petitioner] to the district court" (Pet. App. B4-B5). The court declined to "address issues that were not presented to and ruled upon by the district court" (*id.* at B5).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Section 6031 of the Internal Revenue Code provides that "[e]very partnership (as defined in Section 761(a)) shall make a return for each taxable year" (26 U.S.C. 6031(a)). Section 6698 of the Code further provides that "if any partnership required to file a return under section 6031 for any taxable year * * * fails to file such return at the time prescribed * * * such partnership shall be liable for a penalty determined under [Section 6698(b)] * * * unless it is shown that such failure is due to reasonable cause" (26 U.S.C. 6698(a)). The term "partnership" is defined for this purpose in Section 761(a) of the Code to "include a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on" (26 U.S.C. 761(a)).

Petitioner has acknowledged that it is a "partnership" within this statutory definition (Pet. App. B4). Petitioner now asserts that it nonetheless should not have been subject to a penalty because its failure to file the required returns was "due to reasonable cause" (26 U.S.C. 6698(a)). As the court of appeals noted, however, petitioner's assertion that it had "reasonable cause" not to file partnership returns had not been "adequately raised, preserved or presented" below and therefore should not be considered on appeal (Pet. App. B4-B5). There is no conflict or other basis warranting further review of that fact-specific application of settled principles by the court of appeals.

Petitioner's reasonable cause argument is, in any event, plainly without merit. As this Court stated in *United States* v. *Boyle*, 469 U.S. 241, 246 (1985) (quoting 26 C.F.R. 301.6651(c)(1) (1984)), "the term 'reasonable cause' is not defined in the Code, but the relevant Treasury Regulation calls on the taxpayer to demonstrate that he exercised 'ordinary business care and prudence' but nevertheless was 'unable to file the return within the prescribed time.'" In this case, petitioner strongly advised its members against filing income tax returns and, following its own advice, filed no returns during the ten-year period from 1979 through 1988 (Pet. App. A7). As the district court held, "even if it was a political organization, [petitioner] still had an obligation to report 'political organization taxable income' as defined by [26 U.S.C.] 527(c). [Petitioner] certainly generated such income through the operation of the NCE" (Pet. App. A16). Petitioner also did not file reporting forms for any of its employees and contractors (see page 6, *supra*) and did not seek a ruling from the Service concerning whether it was exempt from the filing requirements of the Internal Revenue Code (*ibid.*). Petitioner did not exercise even the slightest care, let alone ordinary business care, in deciding not to file returns. It simply carried out its philosophy of deliberate non-filing.

2. There is no merit to petitioner's argument (Pet. 16-22) that its status as a political organization insulated it from the Section 6698 penalty.[4] To qualify

---

[4] The government contended in the courts below that, because this claim was not raised in petitioner's administrative claim for refund, it could not be litigated in a tax refund suit. See *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U.S. 269, 272 (1931).

as a "political organization," an organization must be "organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function" as defined in Section 527(e)(1) of the Code. An "exempt function" is defined as (26 U.S.C. 527(e)(2)):

> the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

There is no evidence demonstrating that petitioner was organized and operated primarily for the function of influencing or attempting to influence the selection, nomination, election, or appointment of public officers. To the contrary, petitioner's newsletter frankly declared that its warehouse banking system was "THE HEART OF OUR MOVEMENT" (C.A. App. 288). A former staff member of petitioner testified that "[petitioner] did really nothing to change the government politically or even to try to change any laws" (C.A. Supp. App. 132). The district court thus correctly found (Pet. App. A16) that the evidence did not support petitioner's claim that it was a political organization under Section 527(e).

3. Nor is there merit to petitioner's contention that the court of appeals should have considered "whether [the partnership] was a much smaller partnership than [was] alleged by [the] IRS" (Pet. 10). Petitioner's theory is that its financial operations involved only a

"handful" of partners and that the amount of the penalty should therefore be reduced (Pet. 9).

The district court correctly found that petitioner failed to meet its burden of proof on this issue (Pet. App. A16).[5] Further review of this factual determination, concurred in by both courts below, is not warranted. See, *e.g.*, *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).

4. Petitioner errs in contending (Pet. 12-14) that the decision in this case conflicts with *Commissioner* v. *Culbertson*, 337 U.S. 733 (1949). In *Culbertson*, the Court considered whether a partnership composed of family members did not qualify as a "partnership" under the Internal Revenue Code—even if it fell within the literal terms of the statutory definition—because it was merely a device to effectuate a division of income in an effort to permit the family to circumvent progressive income tax rates. *Id.* at 735. The question that the Court focussed on was "whether the family partnership is real for income-tax purposes." *Id.* at 741. The Court concluded that even a family may form a valid partnership if there is a "bona fide intent of the parties to join together as partners" (*id.* at 743).

Nothing in *Culbertson* supports any suggestion that the statutory definition of "partnership" is not to be

---

[5] Petitioner argues that "[the] IRS bears the burden of proof when it alleges fraudulent conduct on the part of a taxpayer." (Pet. 20). That contention misses the point, however, for fraudulent conduct is not a prerequisite to the imposition of penalties under Section 6698. It is well established that, in a refund suit, the taxpayer, rather than the Commissioner, bears the burden of proving the amount he is entitled to recover. *United States* v. *Janis*, 428 U.S. 433, 440-441 (1976); *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932).

given its plain meaning. In the present case, petitioner's status as a "partnership" under Section 761(a) was determined by application of the plain language of the governing statute to a business entity conducting financial operations (Pet. App. A10-A16). As the courts below correctly concluded, the statute applies directly to the facts of this case.

5. Petitioner errs in relying (Pet. 15-23) upon *NAACP* v. *Claiborne Hardware Co.*, 458 U.S. 886 (1982), and *NAACP* v. *Alabama*, 357 U.S. 449 (1958), for the proposition that the penalties assessed in this case violate the First Amendment. Those cases do not hold that an unincorporated association that carries on a substantial financial operation, such as petitioner's warehouse bank, is excused by the First Amendment from complying with the provisions of the Internal Revenue Code.

Similarly, petitioner errs in contending (Pet. 16) that the penalty reflects an improper effort to obtain its membership lists. Here, as in *Pleasant* v. *Lovell*, 974 F.2d 1222, 1233 (10th Cir. 1992), "[t]he evidence does not support [petitioner's] notion that [the] * * * motive [of the IRS employees] was to harass or disrupt [petitioner] in any legal political pursuits."

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

JONATHAN S. COHEN
ROBERT W. METZLER
Attorneys

JUNE 1995